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Review: BoE Remains on Hold in September,

But Remains Ready to Increase Rates

by

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Executive Summary

- **Decision Made**: *The Bank of England (BoE) kept its Bank Rate at to 3.75%.* The MPC left Bank Rate unchanged at 3.75% for a six consecutive meeting in a 6-3 vote. Megan Greene, Catherine L. Mann, and Huw Pill dissented in favour of a 25bp hike, pointing to the upside risks to inflation. The Committee stands ready to act to ensure inflation returns to the 2% target, while closely monitoring developments in the Middle East and their impact on global energy markets. Under the multi-year plan, holdings will be unwound at an average annual pace of £46 billion through £20 billion in yearly gilt sales alongside maturing bonds.
- **Policy Discussion**: *Bailey pushed back against markets pricing almost four rate hikes over the next year, saying the outlook remained too unpredictable and that the MPC had not discussed such a path.* Financial conditions have tightened further since July, adding to monetary restraint, but the MPC judged inflation risks had shifted further to the upside as persistent Middle East tensions pushed energy prices higher and increased the risk of second-round effects.

  Six members (Bailey, Breeden, Dhingra, Lombardelli, Ramsden and Taylor) voted to hold Bank Rate at 3.75%, judging that tighter financial conditions and weak domestic activity were providing sufficient restraint despite growing inflation risks. Dhingra and Taylor placed particular weight on economic slack, limited cost pass-through and the restrictive policy stance. Bailey similarly noted that energy costs have so far had limited effects on wage and price-setting, while warning that persistent pressures could eventually require higher rates.

  The three dissenters (Greene, Mann and Pill) backed a 25bp hike, arguing that higher energy and food prices and stronger activity increased the risk of second-round effects as economic slack appeared to be peaking. Mann favoured acting early to avoid more aggressive tightening later, Greene highlighted additional risks from AI-related supply constraints and El Niño, while Pill argued that a hike would reinforce price stability. Separately, Bailey said the pause in active gilt sales and halt to long-dated sales were planned before the Middle East conflict and were not a response to recent market volatility.

Key Assumptions and Judgements In Scenarios from July MPR

	Central projection	Milder scenario	Adverse scenario
Energy prices	Energy prices for wholesale oil and gas follow the market futures curves over the 15 UK working days to 20 July.	Energy future prices follow the paths around 1 July, capturing the lower prices after the signing of the Memorandum of Understanding (MoU).	Energy prices rise materially above the central projection and remain persistently higher over the forecast period.
Second-round effects from recent energy shock	Moderate additional second-round effects, consistent with some effect on short-term inflation expectations and hence wages. In addition, heightened attentiveness to inflation also contributes to second-round effects.	No new second-round effects from the recent energy shock, owing to weaker worker bargaining and firm pricing power. This partly reflects weaker demand, driven by a greater degree of saving than in the central projection.	Stronger and more persistent additional second-round effects relative to the central projection and milder scenario. This stems from a greater effect of the energy shock on long-run inflation expectations and hence wages and prices.

Source: Bank of England

Analysis

- **DECISION MADE**: *On September 17, in line with consensus, the Bank of England (BoE) held its Bank Rate at 3.75%.* The MPC voted 6-3 to hold the Bank Rate at 3.75% for a six consecutive meeting. Protracted Middle East conflict has pushed crude and refined energy prices higher and kept them volatile, while UK CPI inflation rose to 3.1% in August and is expected to increase further.

  The Committee judges inflation risks to be increasingly tilted to the upside since July, though the outlook remains sensitive to developments in the Middle East.

  In terms of *forward guidance*, the Committee stands "ready to act" as needed to ensure inflation returns to the 2% target over the medium term. The Committee will closely monitor developments in the Middle East and their impact on global energy supply and prices.

  In terms of *balance sheet policy*, the BoE will reduce its £368 billion stock of government bonds held for monetary policy purposes to zero by the end of 2034. Under the multi-year plan, holdings will be unwound at an average annual pace of £46 billion through £20 billion in yearly gilt sales alongside maturing bonds. As of 16 September, the BoE held £488 billion in UK government bonds purchased for monetary policy purposes.

- **POLICY DISCUSSION:** *Bailey pushed back against markets pricing almost four rate hikes over the next year, saying the outlook remained too unpredictable and that the MPC had not discussed such a path.* Financial conditions have tightened further since July, with higher short-term market rates feeding through to household and business borrowing costs and adding to monetary restraint. However, the MPC judged that inflation risks had shifted further to the upside as the prolonged Middle East conflict pushed energy prices higher and increased the risk of second-round effects. The key policy divide was whether existing monetary restraint was sufficient or whether a pre-emptive rate increase was warranted.

  Six members (Bailey, Breeden, Dhingra, Lombardelli, Ramsden and Taylor) voted to hold Bank Rate at 3.75%. They acknowledged that persistent energy pressures could keep inflation above target for longer, but judged that tighter financial conditions and still-weak domestic activity were providing sufficient restraint. Dhingra and Taylor placed particular weight on economic slack, limited evidence of cost pass-through and the already restrictive policy stance, arguing that these provided scope to wait for further evidence. Bailey similarly noted that higher global energy costs have so far had only a limited effect on UK wage and price-setting, while warning that persistent volatility could eventually require higher rates to return inflation sustainably to the 2% target.

  The three dissenters (Greene, Mann and Pill) voted for a 25bp hike, arguing that persistent Middle East tensions, rising energy and food prices and stronger-than-expected activity increased the risk of second-round effects. With GDP and employment suggesting that economic slack may have peaked, they favoured acting before inflationary pressures became embedded, particularly with inflation expected to rise above 4% around the early-2027 wage-setting period. Mann viewed an immediate hike as preferable to potentially more aggressive tightening later, while Greene also highlighted inflationary pressures from AI-related supply constraints and El Niño. Pill argued that a hike would reinforce the MPC's commitment to price stability and help prevent second-round effects from becoming entrenched.

  Looking ahead, Bailey stressed the unusually high uncertainty surrounding the policy outlook and stopped short of validating market expectations for further tightening. Separately, he said the BoE's decision to pause active gilt sales for six months and halt sales of long-dated gilts was not a response to recent market volatility, despite 30-year yields reaching their highest level since 1998, noting that the plans had been under development before the Middle East conflict began.

- **ECONOMIC ASSESSMENT**: *The protracted Middle East conflict and resulting energy shock remain the main source of uncertainty for UK inflation.* UK growth has proved more resilient than expected, with GDP rising 0.4% q-o-q in Q2 and 0.4% m-o-m July, supported by business services. Improving PMIs, business optimism and consumer confidence prompted Bank staff to raise their Q3 growth estimate to 0.4%, from 0.1% in the July Report, although surveys still signal softer momentum. Labour demand remains weak, with unemployment at 4.9% in the three months to July and some slack persisting. However, hiring and employment indicators improved in August alongside stronger activity, suggesting that labour-market slack has broadly stabilised.

  Energy prices have risen further since July, with Bank staff now estimating CPI inflation could peak slightly above 4% in early 2027. With spot energy prices approaching levels in the July adverse scenario, most MPC members now place greater weight on prices remaining higher for longer without a lasting de-escalation.

  The key medium-term risk is whether higher energy costs feed into wages and broader price-setting through second-round effects, which are not yet evident in the data. The MPC therefore continues to balance upside inflation risks against the costs of tighter policy for activity, while assessing whether economic slack will help contain underlying inflation.

- **OUR TAKE:** *On hold today, ready to increase rates.* While this time the BoE remained on hold, it also signalled that it's ready to act, potentially as early as in November, when a 25bps increase may be delivered.

- **MARKET REACTION AND IMPLICATIONS***: The BoE holds rates, prompting a dovish market reaction that weakened sterling as investors pared tightening expectations.* Gilt yields fell sharply after the BoE decision, with the 10-year yield down 8bp to 5.22% and the 30-year yield dropping nearly 12bp to 5.74%. *In the currency space,* the Sterling fell sharply following the BoE decision, reversing earlier gains to trade around $1.3375. The pound had been broadly steady ahead of the meeting, while the dollar remained supported after the Fed's rate hike and hawkish inflation stance pushed the greenback to a seven-week high. *In the equity space,* UK equities advanced following the BoE decision, with the FTSE 100 rising 0.58% to 10,750.50 and the FTSE 250 gaining 0.72%. The gains followed the announcement that the Bank would halt sales of long-dated gilts.

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